

TRS Out-of-State Service Credit

Background

This proposal is an outgrowth of the Age 65 study and was presented as one of the Age 65 Retirement Options. Currently members of TRS may use out-of-state service credit solely for the purpose of determining the time at which they may retire. (Such service credit is not purchased and it is not membership service.) This proposal focuses on acquiring out-of-state service credit that can be used not only for retirement eligibility, but also to increase the member's retirement benefit.

Committee Activity

Presentations:

September 7, 2004 - Full Committee
October 19, 2004 - Full Committee
November 9, 2004 - Executive Committee

Subgroup Activity:

October 14, 2004 - Subgroup meeting
November 5, 2004 - Subgroup meeting

Proposal:

December 7, 2004 - Full Committee

Recommendation to Legislature

Allow eligible members of the TRS Plans 2/3 to make a one-time purchase of up to seven years of membership service credit for public education experience as a teacher in a public school in another state or with the federal government. The member must have at least five and less than ten years of service credit in TRS to be eligible. The member pays an amount that includes applicable employer and employee contribution rates plus interest.

Staff Contact

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Select Committee on Pension Policy

TRS Out-of-State Service Credit

(November 30, 2004)

Issue

The issue before the SCPP is whether to propose legislation allowing eligible members of the Teachers' Retirement System (TRS) Plans 2 and 3 to purchase up to seven years of membership service credit for public education experience as a teacher in a public school in another state or with the federal government.

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Members Impacted

This proposal impacts eligible members of TRS Plans 2 and 3. We estimate that 1,371 TRS 2 members out of 7,637 active TRS 2 members, and 26,038 TRS 3 members out of 47,263 active TRS 3 members would be affected by this bill.

Current Situation

Currently members of TRS may use out-of-state service credit solely for the purpose of determining the time at which the member may retire. The service credit is not purchased and it is not membership service. The member's benefit is actuarially reduced to recognize the difference between the age a member would have first been able to retire based on service in the State of Washington and the member's retirement age using the out-of-state service credit.

Proposal

This bill impacts the Teachers' Retirement System (TRS) by allowing members of Plans 2 and 3 to make a one-time purchase of up to seven years of service credit for public education experience (state and federal) outside the Washington State Retirement System. The public education experience claimed must have been covered by a governmental retirement or pension plan, and the member must not be receiving or eligible to receive an unreduced retirement benefit that includes the service to be purchased. To take advantage of this provision, a member must have at least five and less than ten years of service credit in TRS. The purchase cannot result in the purchase of service credit that is greater than the member's total years of creditable service in the retirement system. The service credit purchased is membership service and may be used to qualify the member for retirement.

The member pays the product of the sum of the applicable employer and employee contribution rates multiplied by the member's salary at the time of purchase, and further multiplied by the total number of years of service credit to be purchased, plus compounded interest for the period for which the service credit is purchased at a rate equal to the investment rate of return assumption set forth in the actuarial funding chapter, Chapter 41.45 RCW. The applicable employer and employee contribution rates are based on the member's age at entry into TRS and calculated under the entry age normal cost method. All or part of the cost may be paid by a rollover or transfer from an eligible retirement plan, and the employer may pay all or a portion of the member's cost.

Policy Analysis

This proposal provides a benefit to the TRS Plans 2 and 3 that is not available in the SERS or PERS Plans 2/3. This proposal is inconsistent with the legislative policy that the retirement systems of the state shall provide similar benefits wherever possible. See RCW 41.50.005(1). If passed this proposal could lead to "leapfrogging" in that members of other retirement systems may seek similar or improved service credit purchase opportunities in the future. Proponents of this legislation have argued that the teaching profession has a unique need for this benefit in order to assist in recruitment and retention of teachers.

It should be noted that TRS members have another service credit option that PERS and SERS members do not have: the ability to elect to apply service credit earned in an out-of-state retirement system that covers teachers in public schools solely for the purpose of determining the time at which the member may retire. See RCW 41.32.065. TRS members are not required to pay for the out-of-state credit, as it is not used to increase the amount of their benefit.

On the other hand TRS Plan 2/3 members do not have a service credit option that PERS and SERS Plan 2/3 members have, which is the ability at retirement to make a one-time purchase of up to five years of additional service credit (or “air time”) in order to offset the required benefit reductions for early retirement. The SCPP is considering a proposal this interim that would extend this option to TRS Plan 2/3 members. There is no cost for this proposal because the purchase price for “air time” is the actuarial cost, which is paid in full by the member.

Procedural Posture/Executive Committee Recommendation

As the result of the September 7, 2004 briefing of the SCPP on the issue of Age 65 Retirement, an “age 65 subgroup” was formed to make specific recommendations to the SCPP. Last month, the subgroup recommended to the Executive Committee that the SCPP consider legislation to provide eligible members of TRS Plans 2/3 the opportunity to purchase up to seven years of out-of-state service credit as membership service. On November 9, 2004, the Executive Committee directed staff to prepare a bill draft and fiscal note on the out-of-state service credit proposal.

Bill (Draft)

The bill draft for this proposal is attached.

Fiscal Note (Draft)

The draft fiscal note for this proposal is attached.

1 AN ACT Relating to purchasing service credit in plan 2 and plan 3
2 of the teachers' retirement system for public education experience
3 performed as a teacher in a public school in another state or with the
4 federal government; adding new sections to chapter 41.32 RCW; and
5 providing an effective date.

6 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

7 NEW SECTION. **Sec. 1.** A new section is added to chapter 41.32 RCW
8 under the subchapter heading "plan 2" to read as follows:

9 (1) An active member who has completed a minimum of five years of
10 creditable service in the teachers' retirement system may, upon written
11 application to the department, make a one-time purchase of up to seven
12 years of service credit for public education experience outside the
13 Washington state retirement system, subject to the following
14 limitations:

15 (a) The public education experience being claimed must have been
16 performed as a teacher in a public school in another state or with the
17 federal government;

18 (b) The public education experience being claimed must have been

1 covered by a retirement or pension plan provided by a state or
2 political subdivision of a state, or by the federal government;

3 (c) The member is not currently receiving a benefit or currently
4 eligible to receive an unreduced retirement benefit from a retirement
5 or pension plan of a state or political subdivision of a state or the
6 federal government that includes the service credit to be purchased;

7 (d) The member has less than ten years of creditable service in the
8 retirement system; and

9 (e) The purchase will not result in the purchase of service credit
10 years that exceed the member's total years of creditable service in the
11 retirement system at the time of purchase.

12 (2) The service credit purchased shall be membership service, and
13 may be used to qualify the member for retirement.

14 (3) The member shall pay the product of the sum of the employer and
15 employee contribution rates multiplied by the member's annualized
16 salary at the time of purchase and further multiplied by the total
17 number of years of service credit to be purchased, plus compounded
18 interest for the period for which the service credit is purchased at a
19 rate equal to the investment rate of return assumption set forth in
20 chapter 41.45 RCW. Compounded interest shall be applied to each year
21 of service credit purchased as follows: No interest for the first
22 year, one years' interest for the second year, two years' interest for
23 the third year, three years' interest for the fourth year, four years'
24 interest for the fifth year, five years' interest for the sixth year,
25 and six years' interest for the seventh year. The applicable employer
26 and employee contribution rates shall be based on the member's age at
27 entry into the retirement system and calculated under the entry age
28 normal cost method.

29 (4) The member may pay all or part of the cost of the service
30 credit to be purchased with a lump sum payment, eligible rollover,
31 direct rollover, or trustee-to-trustee transfer from an eligible
32 retirement plan. The department shall adopt rules to ensure that all
33 lump sum payments, rollovers, and transfers comply with the
34 requirements of the internal revenue code and regulations adopted by
35 the internal revenue service. The rules adopted by the department may
36 condition the acceptance of a rollover or transfer from another plan on
37 the receipt of information necessary to enable the department to

determine the eligibility of any transferred funds for tax-free rollover treatment or other treatment under federal income tax law.

(5) The employer may pay all or a portion of the member's cost of the service credit purchased under this section.

NEW SECTION. **Sec. 2.** A new section is added to chapter 41.32 RCW under the subchapter heading "plan 3" to read as follows:

(1) An active member who has completed a minimum of five years of creditable service in the teachers' retirement system may, upon written application to the department, make a one-time purchase of up to seven years of service credit for public education experience outside the Washington state retirement system, subject to the following limitations:

(a) The public education experience being claimed must have been performed as a teacher in a public school in another state or with the federal government;

(b) The public education experience being claimed must have been covered by a retirement or pension plan provided by a state or political subdivision of a state, or by the federal government;

(c) The member is not currently receiving a benefit or currently eligible to receive an unreduced retirement benefit from a retirement or pension plan of a state or political subdivision of a state or the federal government that includes the service credit to be purchased;

(d) The member has less than ten years of creditable service in the retirement system; and

(e) The purchase will not result in the purchase of service credit years that exceed the member's total years of creditable service in the retirement system at the time of purchase.

(2) The service credit purchased shall be membership service, and may be used to qualify the member for retirement.

(3) The member shall pay the product of the employer contribution rate multiplied by the member's annualized salary at the time of purchase and further multiplied by the total number of years of service credit to be purchased, plus compounded interest for the period for which the service credit is purchased at a rate equal to the investment rate of return assumption set forth in chapter 41.45 RCW. Compounded interest shall be applied to each year of service credit purchased as follows: No interest for the first year, one years' interest for the

1 second year, two years' interest for the third year, three years'
2 interest for the fourth year, four years' interest for the fifth year,
3 five years' interest for the sixth year, and six years' interest for
4 the seventh year. The total amount paid by the member shall be deemed
5 a contribution on behalf of the employer for the purpose of RCW
6 41.32.867, and shall not be refundable. The applicable employer
7 contribution rate shall be based on the member's age at entry into the
8 retirement system and calculated under the entry age normal cost
9 method.

10 (4) The member may pay all or part of the cost of the service
11 credit to be purchased with a lump sum payment, eligible rollover,
12 direct rollover, or trustee-to-trustee transfer from an eligible
13 retirement plan. The department shall adopt rules to ensure that all
14 lump sum payments, rollovers, and transfers comply with the
15 requirements of the internal revenue code and regulations adopted by
16 the internal revenue service. The rules adopted by the department may
17 condition the acceptance of a rollover or transfer from another plan on
18 the receipt of information necessary to enable the department to
19 determine the eligibility of any transferred funds for tax-free
20 rollover treatment or other treatment under federal income tax law.

21 (5) The employer may pay all or a portion of the member's cost of
22 the service credit purchased under this section.

23 NEW SECTION. **Sec. 3.** This act takes effect January 1, 2006.

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DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/16/04	Z-0242.1/Z-0252.1

SUMMARY OF BILL:

This bill impacts the Teachers' Retirement System (TRS) by allowing members of Plans 2 and 3 to make a one-time purchase of up to seven years of service credit for public education experience (state and federal) outside the Washington State Retirement System. The public education experience claimed must have been covered by a governmental retirement or pension plan, and the member must not be receiving a benefit or eligible to receive an unreduced retirement benefit that includes the service to be purchased. To take advantage of this provision, a member must have at least five and less than ten years of service credit in TRS. The purchase cannot result in the purchase of service credit that is greater than the member's total years of creditable service in the retirement system.

The member pays the product of the sum of the applicable employer and employee contribution rates multiplied by the member's salary at the time of purchase, and further multiplied by the total number of years of service credit to be purchased, plus compounded interest for the period for which the service credit is purchased at a rate equal to the investment rate of return assumption set forth in the actuarial funding chapter, Chapter 41.45 RCW. The applicable employer and employee contribution rates are based on the member's age at entry into TRS and calculated under the entry age normal cost method. All or part of the cost may be paid by a rollover or transfer from an eligible retirement plan, and the employer may pay all or a portion of the member's cost. The service credit purchased is membership service and may be used to qualify the member for retirement.

Effective Date: January 1, 2006.

CURRENT SITUATION:

Currently members of TRS may use out-of-state service credit solely for the purpose of determining the time at which the member may retire. The service credit is not purchased and it is not membership service. The member's benefit is actuarially reduced to recognize the difference between the age the member would have first been able to retire based on service in the State of Washington and the member's retirement age using the out-of-state service credit.

MEMBERS IMPACTED:

We estimate that 1,371 TRS 2 members out of 7,637 active TRS 2 members, and 26,038 TRS 3 members out of 47,263 active TRS 3 members would be affected by this bill.

We estimate that a typical member impacted by this bill would purchase 1.15 years of out-of-state service. The entry age normal cost rate used to determine the purchase price would vary by the member's entry age. The cost of purchasing 1.15 years of service for a typical member with a salary of \$50,000 would be as follows:

Plan 2 Member: $\$50,000 \times 11.80\% \times (1 + 1.08(.15)) = \$6,856$

Plan 3 Member: $\$50,000 \times 5.90\% \times (1 + 1.08(.15)) = \$3,428$

ASSUMPTIONS:

We estimated that the average member would buy 1.15 years of service based on a sample of out-of-state service for 6,850 members. These members had a total of 10,815 years of out-of-state service, or an average of 1.58 years per member. When the service was limited to 7 years, the members in the sample had a total of 7,910 years, or an average of 1.15 years.

Plan 2 members pay both the member and the employer rate. Plan 3 members pay the employer rate only. The contributions to purchase Plan 2 service would be included with the regular and refundable Plan 2 member contributions. The contributions to purchase Plan 3 service would not be refundable but would be used to determine the Plan 3 defined benefit. The purchase of the first year has no interest. The second year interest rate is 8%.

We included the out-of-state service for the benefit calculation, retirement eligibility, and vesting service. Some of our demographic assumptions such as turnover and step salary increases are service based. Our experience studies to determine these rates are based on TRS service only. For estimating the cost of this bill, we assumed that a member's turnover and merit increases would be based on service with TRS only.

FISCAL IMPACT:

Description:

The member would pay for the cost of the additional service, but the plan would be would partially subsidizing the cost because the interest is based on the date of purchase, not on the adjusted date of hire.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System and the required actuarial contribution rate as shown below:

<i>(Dollars in Millions)</i>	Current	TRS 2/3 Increase	Total
Actuarial Present Value of Projected Benefits (The Value of the Total Commitment to all Current Members)	\$5,220	\$19	\$5,239
Unfunded Actuarial Accrued Liability (The Portion of the Plan 1 Liability that is Amortized at 2024)	N/A	N/A	N/A
Unfunded Liability (PBO) (The Value of the Total Commitment to all Current Members Attributable to Past Service)	\$(1,397)	\$15	\$(1,382)
Increase in Contribution Rates: (Effective 9/1/2005)			
Employee (Plan 2)	0.05%		
Employer State	0.05%		

Fiscal Budget Determinations:

As a result of the higher required contribution rate, the increase in funding expenditures is projected to be:

Costs (in Millions):	<u>TRS 2/3</u>
2005-2007	
State:	
General Fund	\$3.7
Non-General Fund	<u>0.0</u>
Total State	\$3.7
Local Government	\$0.8
Total Employer	\$4.5
Total Employee	\$0.4
2007-2009	
State:	
General Fund	\$4.2
Non-General Fund	<u>0.0</u>
Total State	\$4.2
Local Government	\$0.9
Total Employer	\$5.1
Total Employee	\$0.4
2005-2030	
State:	
General Fund	\$108.2
Non-General Fund	<u>0.0</u>
Total State	\$108.2
Local Government	\$22.2
Total Employer	\$130.4
Total Employee	\$3.1

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Teachers' Retirement System.
2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.
3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:
4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.
5. This fiscal note is intended for use only during the 2005 Legislative Session.
6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.
7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.
8. The entry age normal cost increase for the bill is 0.07% for TRS employers. The entry age normal cost increase was used to determine the increase in funding expenditures for future new entrants.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.